UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

SECURITIES AND EXCHANGE
COMMISSION

v. C.A. No. 02-154 ML

DENNIS S. HERULA, ET AL.

MEMORANDUM AND ORDER

This case is before the Court for written decision on the Securities and Exchange Commission's ("SEC") motion for entry of final judgment against defendant Mary Lee Capalbo ("Capalbo"). On Thursday January 2, 2003, the Court held a hearing on the SEC's motion. At the conclusion of that hearing the Court informed counsel that it would take the matter under advisement and that a written decision would follow. The facts as set forth in this Court's Memorandum and Order dated May 1, 2002, granting the SEC's motion for a preliminary injunction, are hereby incorporated into this decision and are the basis for this Court's finding that the relief set forth herein is appropriate.

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I. Procedural History

The SEC filed its complaint in this matter on April 1, 2002, and filed an amended complaint on April 3, 2002, alleging that Capalbo, along with a number of other defendants including her husband, Dennis Herula ("Herula"), violated the anti-fraud provisions of the federal securities laws in connection with a sham "investment program" that involved the fraudulent offering of securities and the misappropriation of investor funds. Following the SEC's filing of an emergency motion for a temporary restraining order ("TRO"), an order freezing the defendants' assets, and for other equitable relief, this Court granted the TRO ex parte on April 3, 2002. On April 23 and 24, 2002, the Court held an evidentiary hearing on the SEC's motion for a preliminary injunction and, on April 24, issued an oral decision granting the SEC's motion for a preliminary injunction and asset freeze as to a number of the defendants, including Capalbo. On May 1, 2002, the Court issued a Memorandum and Order detailing its oral decision of April 24, and on May 8, 2002, the Court issued a written Preliminary Injunction Order further describing the extent of the relief that had been granted to the SEC. Included in that order was a requirement that the defendants provide a full accounting to the SEC. For a comprehensive discussion of the facts in this case, the Court directs the reader to the May 1, 2002, Memorandum and Order.

Pursuant to Fed. R. Civ. P. 55(a), following both Capalbo and Herula's failure to file an answer to either the complaint or the amended complaint, and upon application by the SEC, on June 7, 2002, the Clerk of this Court entered a default against both defendants. The SEC moved for a default judgment against Capalbo and Herula on July 24, 2002. A hearing on the SEC's motion for default judgment was scheduled for August 29, 2002. Prior to that date, the defense

moved for and received a two-week continuance, until September 9, 2002, in order to prepare to for the hearing. On September 9, 2002, defendants Capalbo and Herula filed an objection to the SEC's motion for entry of default judgment and, included in that objection, defendants moved to vacate the default. That objection was not timely. The Court denied defendants Capalbo and Herula's request to vacate the Clerk's default, and, despite the late filed motion in opposition to the SEC's motion for entry of final judgment, indicated that the Court would proceed with a hearing on the SEC's motion for entry of final judgment on September 16, 2002.

On September 16, 2002, defendant Herula, accompanied by counsel, was present for the hearing before the Court; defendant Capalbo was not, and the matter as it pertained to Capalbo, after being rescheduled for medical reasons and to accommodate her newly retained counsel, proceeded on January 2, 2003.

At the hearing on the SEC's motion as to Herula, the SEC presented the testimony of an SEC investigator, Corliss Primavera, who had traced investor funds that had moved in and out of accounts controlled by Herula and Capalbo. Herula did not present any evidence. This Court granted the SEC's motion for entry of final judgment as to Herula and issued a written decision on October 17, 2002. The Court found Herula liable for disgorgement and prejudgment interest in the amount of $18,941,665.63. In addition, the Court ordered Herula to pay a civil monetary penalty in the amount of $250,000.

The SEC seeks the same relief against Capalbo that it sought against Herula, that is the SEC requests that this Court enter final judgment as to Capalbo (1) permanently enjoining her from violating Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17

C.F.R. § 240.10b-5]; (2) ordering her to disgorge ill-gotten gains; and (3) imposing a civil monetary penalty on her. In support of its position on disgorgement liability, the SEC presented the testimony of SEC investigator Corliss Primavera. Capalbo elected not to present any evidence.

II. Standard

A. *Permanent Injunction*

Once a defendant's liability for violations of the securities laws has been established, a permanent injunction against future violations of the securities laws may issue if the defendant's conduct indicates "that there is a reasonable likelihood of further violations in the future." SEC v. Deyon, 977 F. Supp. 510, 518-19 (D. Maine 1997), aff'd, 210 F.3d 428 (1st Cir. 1997) (citation omitted). In considering the likelihood of recurrence, courts may consider whether the defendant "has been found liable for illegal conduct; the degree of scienter involved; whether the infraction is an 'isolated occurrence;' whether defendant continues to maintain that his past conduct was blameless; and whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated." SEC v. Cavanagh, 155 F.3d 129, 135 (2nd Cir. 1998) (citing SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 100 (2nd Cir. 1978)); SEC v. Moran, 944 F. Supp. 286, 294 (S.D.N.Y. 1996) (stating same); SEC v. Ingoldsby, 1990 WL 120731, at *2 (D. Mass May 15, 1990) (stating same).

B. *Disgorgement*

"Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." SEC v. First City Financial Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989) (citation omitted). The actual dollar figure that a

defendant may be required to disgorge "need only be a reasonable approximation of profits causally connected to the violation." Id. at 1231-32. Once the SEC satisfies its burden of showing that its disgorgement figure reasonably approximates the amount of unjust enrichment, the defendant is then obliged "to [clearly] demonstrate that the disgorgement figure is not a reasonable approximation." Id. at 1232. It is within a court's discretion to assess prejudgment interest on amounts that the defendant is required to disgorge. Moran, 944 F. Supp. at 295. "Requiring payment of interest prevents a defendant from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity." Id. The rate established by the Internal Revenue Service for tax underpayment is an appropriate rate for prejudgment interest because "that rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from [her] fraud." SEC v. First Jersey Securities, 101 F.3d 1450, 1476 (3rd Cir. 1996).

C. *Civil Monetary Penalty*

Where, as here, the violation committed by the defendant involves "fraud, deceit, manipulation, or deliberate disregard of a regulatory requirement; and . . . such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons," Section 20(d)(2)(C) of the Securities Act of 1933 [15 U.S.C. § 77(t)(d)(2)(C)] and Section 21(d)(3)(B)(iii) [15 U.S.C. § 78u(d)(3)(B)(iii)] of the Securities Exchange Act of 1934 authorize the imposition of monetary penalties up to the greater of $100,000 for each violation or the defendant's gross pecuniary gain as a result of the violation, which, in this case, is in the millions of dollars.

III. Discussion

Based on the findings of fact made by this Court in its Memorandum and Order dated May 1, 2002, and incorporated herein, Capalbo is liable for violating Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

The question of whether a permanent injunction should issue against Capalbo may be dealt with in short order. Not only is this Court convinced that there is a likelihood of future violations if Capalbo is not permanently enjoined, her conduct following this Court's entry of a preliminary injunction has convinced this Court that future violations are all but certain. Within a matter of months following this Court's entry of a preliminary injunction, Capalbo was complicit in a scheme to cheat other unsuspecting investors out of their money; this time in California. The District Court for the Northern District of California found that "[a]lthough the SEC has chosen to proceed against Capalbo solely for the purposes of obtaining injunctive relief, rather than to impose on her any substantive liability for violations of the securities laws, the SEC has made a substantial showing that she aided and abetted the securities laws violations in question." Securities and Exchange Commission v. Claude LeFebvre, et al., No. C 02-3704 SBA, slip op. at 9 (N.D. Cal. 2002). Capalbo shared control of an account containing $3,000,000 of investor funds, $2,800,000 of which were dissipated by Capalbo and Herula.[1] The total loss to investors in that case is alleged to have been $40,000,000. Capalbo's brazen willingness to flout the orders of this Court, the shameless use of her status as an attorney to seduce investors, and

[1] Capalbo used some of that money to pay bar fees to the Rhode Island Bar Association where she is, currently, a member in good standing.

the sheer scope of the fraudulent activity in this case, compels this Court to enjoin Capalbo, permanently, from future violations of the securities laws.

The testimony of the SEC investigator in support of the SEC's motion for final judgment established that of the $20,669,532.70 that was invested with the various defendants in this action, $16,708,520.83 had come under Capalbo's direct control, and $8,731,776.95 could actually be traced to one of her personal accounts. The Court finds that the appropriate disgorgement liability in this case is the amount of investor funds that the SEC has shown were under Capalbo's control: $16,708,520.83. When $2,583,581.31 in prejudgment interest is added to that figure, Capalbo's total disgorgement liability comes to $19,292,102.14.

The Court also finds that a monetary penalty is appropriate. The fraud perpetrated by the defendants in this case was massive, and Capalbo showed no compunction about spending investor money as quickly as she possibly could. She and Herula purchased an assortment of luxury items including jewelry, art, cars, trips, and expensive meals. Perhaps even more egregious than Capalbo's outright conversion of investor funds to her personal use, however, is the fact that she traded on her status as an attorney to accomplish the fraud. In complete disregard of her fiduciary obligations and the law, Capalbo allowed her status as an attorney to be used to attract investor funds, then spent the money on herself and lied about the status of the money to the investors. Such a case demands a stiff monetary penalty. Accordingly, the Court orders Capalbo to pay a $250,000 civil penalty.

IV. Conclusion

For the foregoing reasons, the SEC's motion for entry of final judgment against defendant Mary Lee Capalbo is GRANTED. Defendant Mary Lee Capalbo is hereby permanently restrained and enjoined from violating or aiding and abetting violations of Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77(q)(a)] and Section 10-b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]. Defendant Mary Lee Capalbo shall be liable for disgorgement of $16,708,520.83, plus prejudgment interest thereon in the amount of $2,583,581.31, for a total of $19,292,102.14. The disgorgement payment shall be made within thirty (30) days from the date of this ORDER. The payment shall be made by money order, certified check or cashier's check made payable to Clerk, United States District Court and shall be mailed to the Clerk of the Court with a cover letter identifying the name of this action and the docket number. A copy of the letter shall be mailed to Martin F. Healy, Securities and Exchange Commission, 73 Tremont Street, Boston MA 02108.

With respect to the SEC's request for the imposition of a civil monetary penalty pursuant to Section 20(d)(2)(C) of the Securities Act of 1933 [15 U.S.C. § 77(t)(d)(2)(C)] and Section 21(d)(3)(B)(iii) [15 U.S.C. § 78u(d)(3)(B)(iii)] of the Securities Exchange Act of 1934, a penalty in the amount of $250,000 shall be imposed against defendant Mary Lee Capalbo. The payment shall be made within thirty (30) days from the date of this ORDER. The payment shall be made by money order, certified check or cashier's check made payable to the United States Securities and Exchange Commission. The payment shall be transmitted to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 0-3, Washington, D.C. 20549 with a cover letter identifying the name and docket number of this action. A copy of the letter shall be

mailed to Martin F. Healey, Securities and Exchange Commission, 73 Tremont Street, Boston, MA 02108.

This Court shall retain jurisdiction over defendant Mary Lee Capalbo as a party to this matter for all purposes, including the implementation and enforcement of this judgment.

The Clerk of the Court is directed to enter this JUDGMENT forthwith.

SO ORDERED:

Mary M. Lisi
United States District Judge
January 27, 2003